

appropriate committee. At least monthly, the board or an appropriate committee must receive a watch list of existing and/or potential credit problems and summary credit exposure reports, which demonstrate compliance with the corporate credit union's risk management policies.

(2) At a minimum, the corporate credit union must maintain:

(i) A justification for each approved credit line;

(ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and

(iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit line.

§ 704.7 Lending.

(a) *Policies.* A corporate credit union must operate according to a lending policy which addresses, at a minimum:

(1) Loan types and limits;

(2) Required documentation and collateral; and

(3) Analysis and monitoring standards.

(b) *General.* Each loan or line of credit limit will be determined after analyzing the financial and operational soundness of the borrower and the ability of the borrower to repay the loan.

(c) *Loans to member credit unions.* (1) The maximum aggregate amount in unsecured loans and irrevocable lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, shall not exceed 50 percent of capital or 75 percent of the sum of reserves and undivided earnings and paid-in capital, whichever is greater.

(2) The maximum aggregate amount in secured loans and irrevocable lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, shall not exceed 100 percent of capital or 200 percent of the sum of reserves and undivided earnings and paid-in capital, whichever is greater.

(d) *Loans to members that are not credit unions.* Any loan or irrevocable line of

credit made to a member, other than a credit union or a corporate CUSO, must be made in compliance with § 701.21(h) of this chapter, governing member business loans, unless such loan or line of credit is fully guaranteed by a credit union. The aggregate amount of loans and irrevocable lines of credit to members other than credit unions and corporate CUSOs shall not exceed 15 percent of the corporate credit union's capital plus pledged shares.

(e) *Loans to non member credit unions.* A loan to a credit union that is not a member of the corporate credit union, other than through a loan participation with another corporate credit union, is only permissible if the loan is for an overdraft related to the providing of correspondent services pursuant to § 704.12. Generally, such a loan will have a maturity of only one business day.

(f) *Loans to corporate CUSOs.* A corporate credit union may make loans and issue lines of credit to corporate CUSOs, subject to the limitations of § 704.11.

(g) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union and must retain an interest of at least 5 percent of the face amount of the loan. The participation agreement may be executed at any time prior to, during, or after disbursement. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(h) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

§ 704.8 Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The tests that will be used to evaluate instruments prior to purchase;

(3) The maximum allowable percentage decline in net economic value (NEV), compared to current NEV;

(4) The minimum allowable NEV ratio;

(5) The maximum decline in net income (before reserve transfers), in percentage and dollar terms, compared to current net income;

(6) Policy limits and specific test parameters for the interest rate risk simulation tests set forth in paragraph (d) of this section; and

(7) The modeling of indexes that serve as references in financial instrument coupon formulas.

(b) *Asset and liability management committee (ALCO).* A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals.* A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate/share redeemed.

(d) *Interest rate sensitivity analysis.* (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the Treasury yield curve of plus and minus 100, 200, and 300 basis points on its NEV, NEV ratio, and net interest income. If the base case NEV ratio falls below 2 percent at the last testing date, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 2 percent;

(ii) Limit its risk exposure to levels that do not result in an NEV ratio below 1 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 18 percent, except as provided in paragraph (e) of this section.

(2) A corporate credit union that owns an aggregate amount of instruments which possess unmatched em-

bedded options in a book value amount which exceeds 200 percent of the sum of its reserves and undivided earnings and paid-in capital must conduct periodically, as appropriate, additional tests that address market factors which potentially can impact the value of the instruments and that reflect the policy limits addressed in paragraph (a) of this section. These factors should include, but not be limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds;

(iii) Adjustments to the market spread assumptions for non Treasury instruments to consider the impact of widening spreads; and

(iv) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Base-plus.* (1) In performing the rate stress tests set forth in paragraph (d)(1)(i) of this section, the NEV of a corporate credit union which has met the requirements of this paragraph (e) may decline as much as 25 percent.

(2) The corporate credit union must meet additional management and infrastructure requirements and receive NCUA's written approval. The additional requirements are set forth in the NCUA publication Guidelines for Submission of Requests for Expanded Authority. The procedures for processing base-plus authority are the same as those set forth in Appendix B of this part for requesting expanded authorities.

(3) The corporate credit union must evaluate monthly the changes in NEV, NEV ratio, and net interest income for the tests set forth in paragraph (d)(1)(i) of this section.

(4) Regardless of the amount of instruments which possess unmatched embedded options, the corporate credit union must conduct periodically, as appropriate, the tests set forth in paragraph (d)(2) of this section.

(f) *Regulatory violations.* If a corporate credit union's base case NEV or NEV ratio or the NEV or NEV ratio resulting from the tests indicated in

paragraph (d)(1)(i) of this section decline below the limits established by this part and are not brought into compliance within 10 calendar days, operating management of the corporate credit union must immediately report the information to the board of directors, supervisory committee, and NCUA. If any of these measures remain below the limits established by this part within 30 calendar days of the violation, the corporate credit union must submit a detailed, written action plan to NCUA that sets forth the time needed and means by which it intends to correct the violation. If NCUA determines that the plan is unacceptable, the corporate credit union must immediately restructure the balance sheet to bring the exposures back within compliance or adhere to an alternative course of action determined by NCUA.

(g) *Policy violations.* If a corporate credit union's NEV or NEV ratio for any required test(s) exceed the limits established by the board, it must determine how it will bring the exposures within policy limits. The disclosure to the board of the limit violation must occur no later than its next regularly scheduled board meeting.

§ 704.9 Liquidity management.

(a) *General.* In the management of liquidity, a corporate credit union must:

- (1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;
- (2) Regularly monitor sources of internal and external liquidity;
- (3) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and
- (4) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:
 - (i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;
 - (ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and
 - (iii) Be reviewed by the board or an appropriate committee no less fre-

quently than annually or as market or business conditions dictate.

(b) *Borrowing.* A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. The corporate credit union must demonstrate that sufficient contingent sources of liquidity remain available.

§ 704.10 Divestiture.

(a) Any corporate credit union in possession of an investment that fails to meet a requirement of this part must, within 30 calendar days of the failure, report the failed investment to its board of directors, supervisory committee, and NCUA. If the corporate credit union does not sell the failed investment, and the investment continues to fail to meet a requirement of this part, the corporate credit union must, within 30 calendar days of the failure, provide to NCUA a written action plan that addresses:

- (1) The investment's characteristics and risks;
 - (2) The process to obtain and adequately evaluate the investment's market pricing, cash flows, and risk;
 - (3) How the investment fits into the credit union's asset and liability management strategy;
 - (4) The impact that either holding or selling the investment will have on the corporate credit union's earnings, liquidity, and capital in different interest rate environments; and
 - (5) The likelihood that the investment may again pass the requirements of this part.
- (b) NCUA may require, for safety and soundness reasons, a shorter time period for plan development than that set forth in paragraph (a) of this section.
- (c) If the plan described in paragraph (a) of this section is not approved by NCUA, the credit union must adhere to NCUA's directed course of action.